OFFICES OF THE COUNTY EXECUTIVE

Douglas M. Duncan
County Executive

Bruce Romer
Chief Administrative Officer

February 25, 2004

Members of the Montgomery County Council

I am pleased to present to you the Quarterly Report of the Montgomery County Employees' Retirement System ("ERS") for the quarter ended December 31, 2003. This quarterly report is designed to assist you in understanding the current status of the ERS. This report was prepared pursuant to the provisions of Section 33-51(a)(4) of the Montgomery County Code of 1994, as amended.

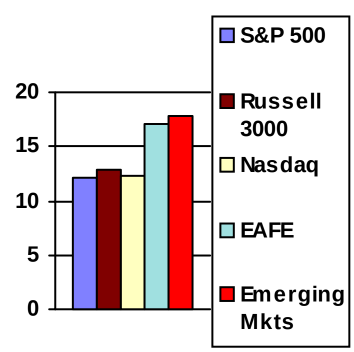
History

The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. In addition to Montgomery County Government, participating agencies and subdivisions include the Montgomery County Revenue Authority, Housing Opportunities Commission of Montgomery County, independent fire/rescue corporations, Town of Chevy Chase, Strathmore Hall Foundation, Inc., Washington Suburban Transit Commission, and certain employees of the State Department of Assessments and Taxation and the District Court of Maryland. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were 5,876 active members and 4,370 retirees participating in the ERS as of June 30, 2003.

Capital Markets and Economic Conditions

Stock markets continued to rise during the December quarter propelled by both business and consumer spending, improving labor markets, strong durable goods orders and low inflation. As shown in the chart below, all markets recorded positive results, with the largest returns coming from Europe and the emerging markets areas. Within the United States, the S&P 500 Index was up 12% in the fourth quarter after earnings reports came in better than expected and companies attributed their profits to growing revenues rather than cost cutting efforts. Internationally, the dollar weakened substantially against the euro and other currencies. The dollar's weakness served to enhance profits for some U.S. companies and benefited U.S. pension plans investing abroad.

Index Returns
QTR-Dec 2003



Economic data released during the last quarter confirms that the expansion is moving ahead. The Gross Domestic Product report for the third quarter showed growth of 8.2%. Profits were strong, capital-spending growth accelerated for the second quarter in a row, and employment rose at an average monthly rate of 100,000 jobs during the three months ending November.

During the quarter, small company stocks outperformed large company stocks, and investors preferred stocks characterized as value (low price/earnings, low price/book) to stocks with higher growth prospects. Our combined domestic equity performance was 12.32%, slightly behind the benchmark index return of 12.43%. Internationally, our combined performance was 15.55% compared to the 17.11% return of the sector's benchmark. Expansion of global economic growth in Europe, combined with strong corporate earnings, produced solid double digit returns for most major European countries. The Pacific markets also enjoyed positive results for the quarter due to the improving economies in Japan and China. China's growth continued to play a significant role in the economic recovery of Hong Kong and Singapore.

Within the fixed income markets, stronger economic growth and quicker hiring sparked a rise in Treasury yields across the yield curve during the fourth quarter. Bond prices declined, but with coupon payments offseting price declines, most bonds had positive returns for the quarter. Within the various sectors of the bond market, high yield securities (non-investment grade) did the best, with most indices posting 5.6 to 6.9% returns for the quarter. Our combined fixed income return was 2.20% compared to the 1.56% return of the benchmark index. The ERS portfolio of TIPS (Treasury Inflation Protection Securities) earned 2.08%, over 40 basis points ahead of the benchmark.

The total return achieved by the ERS assets for the quarter was 9.38% compared to the benchmark index return of 9.24%. For the one year period ending December 31, the ERS' gross return was 25.95% compared to the benchmark return of 24.57%. The strong one-year return places the ERS' performance in the top ten percent of a universe of public pension funds constructed by the Board's consultant, Wilshire Associates. The outperformance continued through January 31 with the one-year return nearly 130 basis points above the benchmark index. The asset allocation at December 31, 2003 was: Domestic Equities 50.8%, International Equities 17.2%, Fixed Income 26.7%, TIPS 4.7%, Alternative Investments .1%, Cash .2% and Real Estate .3%.

Additions

The primary sources of additions for the ERS include member and employer contributions and investment income. The following tables show the source and amount of additions for the quarter ending December 31, 2003 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income
(millions)

	Qtr 12/31/03	**Fiscal YTD**
Employer Contributions	$ 15.7	$ 31.0
Member Contributions	3.8	7.4
Net Investment Income	164.6	232.1
	$ 184.1	$ 270.5

Deductions

The deductions from the Employees' Retirement System include the payment of retiree and survivor benefits, participant refunds, administrative expenses and other costs.

Employees' Retirement System Deductions by Type (millions)	**QTR 12/31/03**	**Fiscal YTD**
Benefits	$26.3	$54.5
Refunds	.1	.3
Administrative Expenses	.6	1.1
	$27.0	$55.9

Outlook

Calendar year 2003 was a welcome relief to equity investors who experienced the worst bear market since the Great Depression in the three previous years. The S&P 500 Index returned 29% in 2003. Although some projections indicate stocks have become expensive, price/earnings ratios finished the year where they started because corporate earnings advanced at the same rate as stock prices. As we look forward to 2004, equity returns for both domestic and international stocks are projected to be in the 7.50 to 7.75% range and bond returns in the 4.25 to 6.50% range.

Major Initiatives

During the last quarter, the Board expanded its investments in the alternatives asset class by hiring a second private equity fund-of-funds manager. Funding will take place as investment opportunities become available over the next several years. The Board reviewed and gave preliminary approval of Board related expenses for the FY 05 requested budget. Final approval of the budget will take place at the March Board meeting. In addition, the Board reviewed projected revenue and expenses associated with the Retirement Savings Plan and determined there would be no need to charge an administrative fee to participating agencies in FY 05.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
December 31, 2003

Assets	
Equity in County's pooled cash and investments	$282,138
Investments	
Northern Trust	1,929,747,079
Aetna	9,022,766
Fidelity - Elected Officials Plan	634,070
Fidelity - Deferred Retirement Option Plan	86,556
Total investments	1,939,490,471
Contributions receivable	3,857,370
Fixed assets, at cost:	
Office equipment	111,375
Less: accumulated depreciation	111,375
Net fixed assets	-
Total assets	1,943,629,979
Liabilities	
Benefits payable and other liabilities	2,405,291
Net assets held in trust for pension benefits	**$1,941,224,688**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
December 31, 2003

Additions	**Quarter**	**Fiscal YTD**
Contributions		
Employer	$15,683,167	$30,953,085
Members	3,815,754	7,445,223
Total contributions	19,498,921	38,398,308
Investment income	166,181,582	235,376,686
Less investment expenses	1,601,119	3,237,323
Net investment income	164,580,463	232,139,363
Total additions	184,079,384	270,537,671
Deductions		
Retiree benefits	20,365,886	42,523,593
Disability benefits	4,749,000	9,529,000
Survivor benefits	1,226,000	2,448,500
Refunds	91,330	251,287
Administrative expenses	613,271	1,103,882
Total deductions	27,045,487	55,856,262
Net increase	157,033,897	214,681,409
Net assets held in trust for pension benefits		
Beginning of period	1,784,190,791	1,726,543,279
End of period	**$1,941,224,688**	**$1,941,224,688**